

BBS briefing note

Conversion of Guaranteed Minimum Pensions (GMPs)

The Department for Work and Pensions (DWP) carried out a consultation exercise last year on draft regulations permitting defined benefit schemes to convert Guaranteed Minimum Pensions (GMPs) into ordinary scheme benefits. In January 2009, the DWP published its response to the consultation and the Occupational Pension Schemes (Contracting-Out) (Amendment) Regulations 2009 came into force on 6 April 2009.

This *BBS briefing note* summarises the new provisions.

BACKGROUND

Since 6 April 1978, defined benefit schemes have been able to contract-out of the State Earnings Related Pension Scheme (SERPS), now known as the State Second Pension. Where a scheme elects to contract-out, the sponsoring employer and scheme members pay reduced National Insurance Contributions and, in exchange, the scheme agrees to provide a statutory minimum level of benefit to effectively replace the SERPS pension that would otherwise have been payable. The minimum benefit accrued up until 5 April 1997 was known as the Guaranteed Minimum Pension (GMP) and, although methods of contracting-out have changed over the years, members retain GMP rights today.

The legislative provisions governing how GMPs are calculated, revalued and increased once in payment are complex and differ from those applying to other scheme benefits. As a result, GMPs are calculated and recorded separately.

Section 14 of the Pensions Act 2007 introduced the option for schemes to convert GMPs into ordinary scheme benefits by way of actuarial equivalence.

The 2009 Regulations provide further details on how the GMP conversion process will work. The objective is to simplify administrative processes, reduce scheme administration costs and make the benefit structure easier for members to understand.

It is for the trustees to decide as a matter of principle whether or not to convert some or all of a scheme's GMP liabilities. Where a GMP conversion exercise is to be carried out, the 2007 Act sets out five conditions that must be complied with.

CONDITION 1 – ACTUARIAL EQUIVALENCE

The actuarial value of each member's benefits before and after GMP conversion must be calculated and compared to ensure that the post-conversion benefits are actuarially at least equivalent to the pre-conversion benefits. However, this is not an ongoing requirement and equivalence only needs to be established as at the trustees' chosen "conversion date".

Under the 2009 Regulations, the trustees must obtain advice from the actuary on the appropriate assumptions to be used in calculating the actuarial value of benefits. Having considered that advice, the trustees must decide on the appropriate assumptions and arrange for the actuary to calculate the value of the pre and post-conversion benefits.

The actuary must provide the trustees with a certificate within 3 months of completing the calculations, confirming that the post-conversion benefits are actuarially at least equivalent to the pre-conversion benefits.

CONDITION 2 – PENSIONS IN PAYMENT

Trustees must ensure that pensions in payment do not reduce as a result of the conversion.

CONDITION 3 – DEFINED CONTRIBUTION BENEFITS

GMP conversion cannot be used to change defined benefit GMP rights into defined contribution benefits.



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CONDITION 4 – SURVIVORS’ BENEFITS

A scheme that has converted GMPs must continue to provide survivors’ benefits of:

- at least 50% of the member’s entitlement accrued between 6 April 1978 and 5 April 1997 for a surviving widow; and
- at least 50% of the member’s entitlement accrued between 6 April 1988 and 5 April 1997 for a surviving widower or civil partner.

The rationale behind the retention of survivors’ benefits is that their removal could lead to potential human rights challenges.

CONDITION 5 – PROCEDURAL REQUIREMENTS

Trustees must obtain the sponsoring employer’s consent to the GMP conversion in advance and take all reasonable steps to:

- consult affected members before the conversion (unless the scheme is winding-up); and
- notify all affected members and survivors of the conversion before, or as soon as reasonably practicable after, the conversion.

HM Revenue and Customs (HMRC) must also be notified on or before the conversion date that the conversion is taking place and which individuals are affected. HMRC will calculate a notional GMP for these members and continue to deduct this amount from their SERPS entitlement.

Once the conversion exercise has been completed, the trustees will be discharged of the requirement to provide GMPs for the affected members and the legislation applicable to ordinary scheme benefits will apply to the converted benefits going forward.

GMP conversion will require an amendment to the scheme rules. However, the 2007 Act allows such amendments to be effected by resolution. Furthermore, section 67 of the Pensions Act 1995, concerning the modification of past service rights, will not apply to amendments that enable GMP

conversion in accordance with the above conditions.

THE PENSIONS REGULATOR

The Pensions Regulator will not be monitoring conversion processes or outcomes. However, in “very extreme” circumstances, the Regulator does have the power to suspend a conversion process, declare an amendment void and/or require the trustees to rectify any deficiencies.

POTENTIAL DIFFICULTIES

It will be necessary to establish each affected member’s GMP entitlement and reconcile this with the National Insurance Contributions Office (NICO). Such an exercise is likely to take time and will have cost implications.

The issue of whether and how to equalise GMPs accrued from 17 May 1990 between men and women remains. Whilst the process of GMP conversion may provide schemes an opportunity to tackle this thorny issue, as this will be a requirement for GMP conversion, how GMPs should be equalised is still a matter of some debate.

BBS VIEW

The introduction of the option to convert GMPs into ordinary scheme benefits from 6 April 2009 is to be welcomed.

However, the difficulties identified above together with the upfront costs may outweigh any potential savings in future administrative expenses and so deter many trustees from undertaking such an exercise.

